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Central Regional Office
Office of Emergency Management
Oversight
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**Homeland
Security**

September 29, 2009

MEMORANDUM FOR: Janet Odeshoo, Acting Regional Administrator
FEMA Region V

FROM: *Tonda L. Hadley*
Tonda L. Hadley, Director
Central Regional Office

SUBJECT: *Licking Rural Electrification, Inc.,*
Utica, Ohio
FEMA Disaster Number 1580-DR-OH
Public Assistance Identification Number 089-UYN24-00
Audit Report DD-09-16

We audited public assistance funds awarded to Licking Rural Electrification, Inc. (LRE) located in Utica, Ohio. Our audit objective was to determine whether LRE accounted for and expended Federal Emergency Management Agency (FEMA) grant funds according to federal regulations and FEMA guidelines.

LRE received an award of \$13.9 million from the Ohio Emergency Management Agency (OEMA), a FEMA grantee, for damages caused during severe winter storms, flooding, and mudslides on December 22, 2004, through February 1, 2005. The award provided for 75% funding for 25 large and 2 small projects that were in various stages of completion during our audit.¹ At the time of the audit, FEMA was adjusting the project worksheets (PWs) to reflect final project costs. Therefore, our audit covered the period December 22, 2004, through our cut-off date of March 30, 2009, during which LRE claimed \$14.0 million for direct project costs. We audited all projects under the award (see Exhibit A).

We conducted this performance audit under the authority of the *Inspector General Act of 1978*, as amended, and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

¹ Federal regulations in effect at the time of the disaster set the large project threshold at \$55,500.

We interviewed FEMA, OEMA, and LRE officials; reviewed judgmentally selected samples (generally based on dollar value) of LRE's claimed costs; and performed other procedures considered necessary to accomplish our objective. We did not assess the adequacy of LRE's internal controls applicable to grant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of LRE's method of accounting for disaster-related costs and its procurement policies and procedures.

RESULTS OF AUDIT

LRE accounted for FEMA funds on a project-by-project basis according to federal regulations.² However, LRE did not always follow federal procurement standards in awarding and administering contracts for disaster-related work, and its claim included ineligible and unsupported costs. Therefore, we questioned \$1,255,016 as ineligible or unsupported.

Finding A: Contracting Procedures

LRE did not always follow federal procurement standards in awarding and administering \$10.5 million for disaster-related contract work. As a result, full and open competition did not occur and FEMA had no assurance that LRE paid reasonable prices. We questioned \$986,567 claimed for contract work performed after power was fully restored to LRE's customers because exigent circumstances no longer existed to justify LRE's non-compliance with federal procurement standards.³

Federal procurement standards at 44 CFR 13.36 require, among other things:

- Performance of procurement transactions in a manner providing full and open competition except under certain circumstances. One allowable circumstance is when there is a public exigency or emergency for the requirement that will not permit a delay resulting from competitive solicitation. (13.36(c)(1) and (d)(4)(i))
- Subgrantees maintain records sufficient to detail the significant history of the procurement, including the rationale for the method of procurement, the basis for contractor selection, and basis for the contract price. (13.36(b)(9))
- Subgrantees shall not use time-and-material (T&M) contracts unless a determination is made that no other contract is suitable and provided that the contract includes a ceiling price that the contractor exceeds at its own risk. (13.36(b)(10))
- A cost or price analysis in connection with every procurement action, including contract modifications. (13.36(f)(1))
- Subgrantees' contracts must contain specific provisions listed in 44 CFR 13.36(i).
- Obtain price or rate quotations from an adequate number of qualified sources for purchases under \$100,000. (13.36(d)(1))

² See 44 CFR 13.20(b)(2) ("Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities.")

³ This amount includes \$352,561 also questioned in Findings C and D (see Exhibit B).

In addition, FEMA's *Public Assistance Guide* (FEMA 322, October 1999), page 40, states, "FEMA provides reimbursement for three types of contracts. They are:

- lump sum contracts for work within a prescribed boundary with a clearly defined scope and a total price;
- unit price contracts for work done on an item-by-item basis with cost determined per unit; and
- cost plus fixed fee contracts, which are either lump sum or unit price contracts with a fixed contractor fee added into the price."⁴

The severe winter storms hit much of Ohio knocking out power for thousands of residents and businesses. The damage to LRE's electrical systems was extensive with over 200 miles of lines requiring repair or replacement. LRE quickly moved to restore power by using new and existing contractors, and obtaining the assistance of mutual aid companies.

LRE spent \$1 million for contract work and mutual aid to restore power. Of this amount, \$272,885 was mutual aid and \$738,918 was for non-competitive contracts for debris removal, electrical work, emergency phone and dispatch services, and general contract work. These were T&M contracts that did not contain cost ceilings or contract provisions required by federal regulations. LRE also did not perform the required price analyses. However, we are not questioning these costs because the work was performed to restore power.

LRE restored power to its customers on January 9, 2005, or 17 days after the first storm occurred on December 22, 2004. We considered this time period to be the emergency period for LRE. We concluded that the lack of power constituted exigent circumstances that warranted LRE's use of non-competitive, time-and-material type contracts because it did not have time to solicit competitive bids or develop clear scopes of work until after it had restored power to its customers.

After the emergency period LRE spent \$9.5 million on contract work, properly soliciting and awarding one of its contracts (\$7.2 million). However, LRE did not follow federal procurement standards in awarding \$2,233,727 of contract work that continued after the power was restored. These contracts included non-competitive T&M and unit price contracts. OEMA and LRE officials stated that they thought competition was required only for contracts over \$100,000 for individual PWs, rather than for the entire contract. As shown in the table below, we questioned \$986,567 of the \$2,233,727.

⁴ At the time of the disaster, FEMA had not yet issued the June 2007 *Public Assistance Guide*, which contains the same wording on pages 52-53.

	Costs Questioned	Costs Not Questioned	Totals
During Emergency Period		\$1,011,803	\$ 1,011,803
Properly Contracted		7,213,887	7,213,887
Improperly Contracted:			
Non-competitive T&M	\$ 887,876		
< \$100,000	<u>155,948</u>		
Reasonable Price		1,189,903	
Subtotal Improperly Contracted			<u>2,233,727</u>
Subtotal Questioned Costs	1,043,824		
Adjustments *	<u>(57,257)</u>	<u>57,257</u>	
Totals	<u>\$ 986,567</u>	<u>\$9,472,850</u>	<u>\$10,459,417</u>
*We deducted \$57,257 from our questioned costs because FEMA deobligated this amount based on adjustments OEMA made during our field work. ⁵			

We did not question the remaining \$1,189,903 even though LRE continued using improperly competed unit price and pre-disaster contracts for permanent electrical work and debris removal after the emergency period. We determined these costs were reasonable because the contract prices were equal to or lower than competitively-awarded, post-disaster contracts for the same type work.

The \$986,567 we questioned consists of the following amounts (net of adjustments):

- \$887,876 for three non-competitive T&M contracts. We could not determine the reasonableness of costs for these contracts because LRE did not monitor the work to ensure that the number of hours billed was reasonable and correct.
- \$155,948 for 20 small contracts (less than \$100,000) for which LRE did not obtain an adequate number of quotes. We could not readily determine the reasonableness of costs for these contracts, the majority of which were T&M contracts that were not monitored.

LRE provided no evidence of monitoring T&M contract work both during and after the emergency period. FEMA's *Public Assistance Guide* (FEMA 322, October 1999), page 40, states that applicants must carefully monitor and document contractor expenses. Further, 44 CFR 13.36(b)(2) requires subgrantees to maintain a contract administration system that ensures contractors perform according to the terms, conditions, and specifications of their contracts or purchase orders. LRE officials stated that they monitored the contractors by reviewing their invoices. Reviewing the work and invoices may be appropriate for lump-sum or fixed-unit price contracts, but it is not sufficient for T&M contracts

T&M contracts present higher risks than unit-price contracts because they provide a disincentive for saving costs—the more hours charged to a project, the greater the contractor's potential profit. Therefore, LRE should have mitigated these higher risks by monitoring and documenting

⁵ Of the \$57,257 of adjustments, \$35,383 was for ineligible work related to private property (see Finding D).

contractor activities while the work was being performed. Without such documentation, LRE had no records to compare to contractors' invoices for hours worked and equipment used.

Finding B: Other Contracting Issues

LRE paid a debris contractor \$519,358 for disaster-related work based on fixed unit price per mile bids. However, the contractor billed \$233,434 of the work on a time-and-material basis and \$31,740 for an unspecified number of hours or miles. The contractor's invoices did not include sufficient documentation to support the work accomplished or mileage information necessary to determine whether the rate was comparable to the fixed unit price. We requested this information from LRE, but did not receive it.

LRE also used a prohibited cost-plus-a-percentage-of-cost contract. The contract included a 10% markup on the contractor's costs; however, the contractor charged a 25% markup on its invoices. The markups totaled \$3,275. Markups are a form of cost-plus-a-percentage-of-cost contracts, which are prohibited by federal regulations (44 CFR 13.36(f)(4)). Therefore, we questioned \$268,449 (\$265,174 as unsupported and improperly billed and \$3,275 of markups).

Finding C: Documentation of Costs

LRE claimed \$348,608 of contract costs that were unsupported. The invoices for these costs did not include supporting documentation, such as timesheets and meal or fuel receipts. Federal regulations require subgrantees to maintain records that adequately identify the source and application of funds and to maintain accounting records supported by source documentation, such as cancelled checks, paid bills, payrolls, time and attendance records, and contract documents (44 CFR 13.20(b)(2) and (6)). Therefore, we questioned \$348,608 in unsupported costs.

Finding D: Private Property Repairs and Easement Purchases

LRE claimed \$38,186 for private property repair costs that were ineligible. FEMA's *Public Assistance Policy Digest* (FEMA 321, October 2001), page 94, explains that private property is not eligible for permanent repair restoration under the public assistance program except for instances where there is a threat to public health and safety. LRE also paid \$1,150 to purchase easements on private property, which is not an eligible expense because it is not a disaster-related cost. OEMA agreed that these costs were ineligible and, during our audit, reduced LRE's claim for all but \$3,953 under PW 3157. OEMA officials said they did not adjust PW 3157 because FEMA had already closed it. Therefore, we questioned \$3,953 as ineligible and consider the remainder as funds put to better use because FEMA has deobligated the remaining \$35,383.

RECOMMENDATIONS

We recommend that the Acting Regional Administrator, FEMA Region V:

1. Disallow \$634,006 of improper contracting costs (see Exhibit B).
2. Disallow \$268,449 of improperly billed and unreasonable contract costs and prohibited markups on costs.
3. Disallow \$348,608 of unsupported costs.
4. Disallow \$3,953 of ineligible costs related to private property.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We discussed the results of our audit with FEMA officials on August 10, 2009, and with OEMA and LRE officials on August 11, 2009. FEMA generally agreed with our findings. OEMA and LRE officials withheld comments. Please advise this office by November 30, 2009, of the actions planned or taken to implement the recommendations, including target completion dates for any planned actions. Significant contributors to this report were Paige Hamrick, William Lough, Cheryl Johnson, and Jennifer Burba. Should you have questions concerning this report, please contact me, or your staff may contact Paige Hamrick, Audit Manager, at (214) 436-5200.

Cc: Audit Liaison, FEMA Region V
Audit Liaison, FEMA (Job Code DG8C09)

Schedule of Audited Projects
Licking Rural Electrification, Inc.
FEMA Disaster Number 1580-DR-OH

Project Number	PW Amount ⁶	Finding A	Finding B	Finding C	Finding D	Questioned Costs
355	\$ 40,206	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
439	13,793	0	0	0	0	0
465	997,844	17,271	0		0	17,271
1543	493,993	0	0	0	0	0
2800	360,076	0	0	0	0	0
2911	1,165,673	51,922	5,861	36,961	0	94,744
3053	80,918	1,556	3,155	0	0	4,711
3056	1,009,333	106,676	29,074	10,322	0	146,072
3061	223,713	0	0	0	0	0
3063	371,723	37,689	5,082	2,876	0	45,647
3065	325,453	30,407	4,700	6,419	0	41,526
3066	189,894	17,807	7,947	9,184	0	34,938
3068	163,410	6,111	4,514	1,252	0	11,877
3113	660,746	54,303	7,506	22,440	0	84,249
3115	286,204	24,189	397	6,423	0	31,009
3119	95,476	0	0	0	0	0
3120	421,981	43,709	3,131	21,873	0	68,713
3140	369,407	31,138	9,196	6,073	0	46,407
3145	1,143,502	48,965	33,586	5,680	0	88,231
3147	365,298	35,364	10,332	17,966	0	63,662
3154	1,493,102	155,127	32,980	55,580	0	243,687
3155	715,312	86,611	9,392	38,162	0	134,165
3156	228,263	13,598	4,900	0	0	18,498
3157	511,518	70,413	35,015	51,434	3,953	160,814
3177	211,368	0	0	0	0	0
3178	1,779,573	142,885	61,681	55,245	0	259,811
3182	<u>140,876</u>	<u>10,826</u>	<u>0</u>	<u>718</u>	<u>0</u>	<u>11,544</u>
Totals⁷	<u>\$13,858,655</u>	<u>\$986,567</u>	<u>\$268,449</u>	<u>\$348,608</u>	<u>\$3,953</u>	<u>\$1,607,577</u>

⁶ PW amounts listed are as of March 30, 2009.

⁷ The net amount questioned is \$1,255,016 because Finding A includes \$352,561 questioned twice (see Exhibit B).

Costs Questioned Under Multiple Criteria
Licking Rural Electrification, Inc.
FEMA Disaster Number 1580-DR-OH

We questioned costs in our report related to contracting procedures (Finding A) that, in some instances, were questioned for more than one reason. Recommendation 1, which relates to Finding A, was to disallow questioned costs net of \$352,561 also questioned in Findings C and D.

As shown in the table below, we questioned \$986,567 in Finding A, which includes \$348,608 also questioned in Finding C and \$3,953 also questioned in Finding D. Therefore, if FEMA does not disallow these costs for Findings C and D, FEMA should add them back to the amount recommended for disallowance for Finding A.

Questioned Costs

Finding	Amount	Totals
A. Contracting Procedures:	\$986,567	
Less costs also questioned in C	(348,608)	
Less costs also questioned in D	<u>(3,953)</u>	
Net amount questioned in A		\$ 634,006
B. Other Contracting Issues	\$ 268,449	268,449
C. Documentation of Costs	\$ 348,608	348,608
D. Private Property Repairs and Easement Purchases	\$ 3,953	<u>3,953</u>
Total		<u>\$1,255,016</u>